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No. 88-102

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

MICHAEL F. FOLEY AND NANCY S. FOLEY,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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MEMORANDUM FOR THE RESPONDENTS

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QUESTIONS PRESENTED

1. Whether the Commissioner of Internal Revenue incorrectly applied Section 170 of the Internal Revenue Code of 1954 in reversing seven decades of prior IRS interpretations and disallowing charitable contribution deductions for payments made by individual members of the Church of Scientology solely to participate in religious services of their faith.

2. Whether denying charitable contribution deductions under Section 170 for payments by Scientologists to participate in their faith's core religious sacraments violates the religion clauses of the First Amendment.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
DISCUSSION	2
CONCLUSION	9
APPENDIX	1a

TABLE OF AUTHORITIES

Cases: Page

Christiansen v. Commissioner, 843 F.2d 418 (10th Cir. 1988), *petition for cert. filed*, 56 U.S.L.W. 3881 (U.S. June 10, 1988) (No. 87-2023) 3, 4

Foley v. Commissioner, 844 F.2d 94 (2d Cir. 1988) 1, 3, 6, 7, 8, 9

Graham v. Commissioner, 83 T.C. 575 (1984) 2, 3, 4, 6, 7

Graham v. Commissioner, 822 F.2d 844 (9th Cir. 1987), *cert. granted*, 108 S.Ct. 1994 (1988) (No. 87-1616) 3, 4, 8

Hernandez v. Commissioner, 819 F.2d 1212 (1st Cir. 1987), *cert. granted*, 108 S.Ct. 1467 (1988) (No. 87-963) 3, 4, 8, 9

Miller v. Internal Revenue Service, 829 F.2d 500 (4th Cir. 1987), *petition for cert. filed*, 56 U.S. L.W. 3627 (U.S. March 1, 1988) (No. 87-1449) 3, 4

Neher v. Commissioner, No. 86-1275 (6th Cir. July 19, 1988) 3

Staples v. Commissioner, 821 F.2d 1324 (8th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3592 (Feb. 19, 1988) (No. 87-382) 3, 4, 8

Statutes:

26 U.S.C. § 170 ..... 2, 4, 7

26 U.S.C. § 501 ..... 2, 4

28 U.S.C. § 1254(1) 2

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OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. 1a-11a)[1] is reported at 844 F.2d 94. The order and deci-

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[1] References in this Memorandum are indicated as follows:

To the numbered pages of the Appendix filed with the government's petition in this Court: (Pet. App. ——a);

To the numbered pages of the Appendix of Appellants filed in the court below: (Appell. App. ——);

To the volume number and numbered pages of a four-volume Stipulated Record on Appeal filed in the court below: (Stip. Rec. ——);

To the numbered pages of the trial transcript from the Tax Court proceedings incorporated in the record below: (Tr. ——).

sion of the Tax Court in the case designated by the parties as providing factual and legal findings in this case is reported as *Graham v. Commissioner*, 83 T.C. 575 (1984) (Pet. App. 13a-23a). The order of the Tax Court in this case is unreported (Pet. App. 12a).

JURISDICTION

The judgment of the court of appeals was entered on April 19, 1988. The government's petition for certiorari was filed on July 18, 1988. The jurisdiction of this Court was invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The religion clauses of the First Amendment to the United States Constitution and pertinent portions of 26 U.S.C. § 170 and 26 U.S.C. § 501 are set forth in the Appendix to this memorandum.

DISCUSSION

1. Petitioner, the Commissioner of Internal Revenue (the "Commissioner"), denied respondents, Michael and Nancy Foley, an income tax deduction of $5,881.83 for payments to their church, the Church of Scientology, made solely to participate in the central religious practices of their faith. Disallowance of these deductions produced a tax deficiency of $975.92 (Appell. App. 6-8). Respondents filed a petition in the Tax Court for review of the Commissioner's determination and, along with hundreds of similarly situated Tax Court petitioners who had contributed sums of money to various churches and missions of the same religious denomination, waived trial and, subject to their right of appeal, agreed to be bound by the outcome of similar "test cases." The Commissioner and the respondents stipulated in the Tax Court that such designated cases were typical and that, to the extent relevant, the record of those cases was to be in-

corporated into the record of all proceedings in respondents' case. (Appell. Ap. 11).

The Tax Court ruled in favor of the Commissioner in the test case *Graham v. Commissioner*, 83 T.C. 575 (1984), and on the authority of that decision entered its judgment in favor of the Commissioner in respondents' Tax Court case. Respondents then filed a timely notice of appeal from the Tax Court's decision and appealed to the United States Court of Appeals for the Second Circuit which reversed the decision of the Tax Court. *Foley v. Commissioner*, 844 F.2d 94 (2d Cir. 1988) (Pet. App. 1a).

Similar appeals have been decided by or are pending in all other United States Courts of Appeals except the appellate courts for the District of Columbia and the Federal Circuits.

Six other courts of appeals have issued opinions in appeals based on records identical to that of the instant case and raising similar legal issues. Panels of the First, Fourth, Ninth and Tenth Circuits affirmed the Tax Court's decision. *Hernandez v. Commissioner*, 819 F.2d 1212 (1st Cir. 1987), *cert. granted*, 108 S.Ct. 1467 (1988) (No. 87-963); *Graham v. Commissioner*, 822 F.2d 844 (9th Cir. 1987), *cert. granted*, 108 S.Ct. 1994 (1988) (No. 87-1616); *Miller v. Internal Revenue Service*, 829 F.2d 500 (4th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3627 (U.S. March 1, 1988) (No. 87-1449), and *Christiansen v. Commissioner*, 843 F.2d 418 (10th Cir. 1988), *petition for cert. filed*, 56 U.S.L.W. 3881 (U.S. June 10, 1988) (No. 87-2023). Like the Second Circuit in this case, the Eighth and Sixth Circuits reversed the Tax Court, holding that similar payments were properly deductible. *Staples v. Commissioner*, 821 F.2d 1324 (8th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3592 (Feb. 19, 1988) (No. 87-382) and *Neher v. Commissioner*, No. 86-1275 (6th Cir. July 19, 1988).

By order entered on April 18, 1988, this Court granted the petition for certiorari filed in *Hernandez v. Commissioner*. 108 S.Ct. 1467. By order entered May 23, 1988, this Court granted the petition for certiorari filed in *Graham v. Commissioner* and ordered that case to be consolidated with the *Hernandez* case. 108 S.Ct. 1994. This Court has not yet disposed of the pending certiorari petitions in *Staples*, *Miller* and *Christiansen*.

2. The Commissioner and the taxpayers stipulated that Scientology, the faith whose sacraments are at issue here, is a religion and that the recipients of the contributions, Scientology missions and churches, were, at all relevant times, churches within the meaning of Internal Revenue Code § 170(b)(1)(A)(i) and tax-exempt religious organizations under §§ 170 and 501 of the Code eligible to receive deductible contributions. (Stip. Rec. I 25, ¶¶ 52, 53).[2]

Scientologists believe the enhancement of civilization is linked to their spiritual goals and practices. Adherents of this Church take part in the rituals of "auditing" and "training," the central practices of this faith. The payments at issue here were made in connection with the taxpayers' participation in these religious services.

Auditing takes place one-on-one with the parishioner and a trained Church staff member known as an "auditor." (*Id.* 17, 18, ¶¶ 13, 14, 22). Adherents are taught that "the individual is an immortal spirit who has a mind and a body" and "the highest level of spiritual ability and awareness can be obtained only by progressing on a step-by-step basis through lower and intermediate levels of Auditing." (*Id.* 17-18, ¶ 16). "Every Auditing session is structured and conducted in exact

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[2] The extensive stipulations of fact in *Graham v. Commissioner* were incorporated as binding the parties in the proceedings below. (Appell. App. 11).

accordance with rituals, codes, doctrines and tenets of Scientology." (*Id.* 17, ¶ 15). Auditing is a standardized religious practice, not one designed to satisfy individual tastes or needs: the "structure, ritual and content of each auditing session" is based on the "level of attainment of the Scientologist being audited." (*Id.* 18, ¶ 17). No subject matter is taught, studied or learned during auditing. (*Id.* ¶ 23).[3]

In training, the other religious practice at issue here, parishioners study "the doctrine, tenets, codes, policies and practices of Scientology" and study the scriptures of Scientology to the exclusion of all other materials. (Tr. 111, 117-18; Stip Rec. I 19, ¶ 24). As part of training, a person may audit others. (Tr. 111, 114). Scientologists undergo training to achieve religious enlightenment and the ability to help others (including the ability to audit another person). Scientologists believe that the spiritual benefits derived from auditing and training accrue not only to the individual but also to the public at large. (Tr. 103-05, 115, 129-30, 166-67, 179-80, 203).[4]

The taxpayers testified that they had made their payments so that they or their children could participate in religious services and because they wanted to support the religious goals and projects of their church. (Tr. 166-67, 175, 203, 208, 260-61). None of the tax-

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[3] Dr. Thomas Love, Professor of Religious Studies, California State University at Northridge, California, gave his uncontradicted expert opinion that "auditing" is "the essential religious experience of the Church of Scientology." (Tr. 291.) Dr. Love testified that, as with Eastern religions such as Hinduism and Mahayana Buddhism, "the major emphasis" in the Scientology "is upon affecting the world for good by obtaining one's enlight[en]ment and going out and hopefuly assisting others to do the same." (Tr. 298.) The government presented no expert testimony regarding the religious practices at issue.

[4] Dr. Love testified that "training" is a form of religious observance, comparable to devotional study of sacred texts in the Buddhist and Judaic traditions. (Tr. 314-17).

payers received any material goods or secular services with respect to the payments at issue.

In accordance with the stipulations and testimony, the Tax Court found the practices at issue to be religious. 83 T.C. at 580, 581 ("Petitioners wanted to receive the benefit of various religious services provided by the Church of Scientology. . . . Petitioners Graham and Hermann made payments for which they received religious services. . . . Petitioner Maynard made advance payments . . . [that] entitled him to receipt of [such] services in the future.") As the Second Circuit noted in its decision in the present case: "auditing and training are *the* religious practices of the Church of Scientology." 844 F.2d at 97 (emphasis in original).

The Churches of Scientology have established a schedule of payments for auditing and training and refer to such payments as "fixed donations" or "fixed contributions."[5] (Stip. Rec. I. 21, ¶ 36). Advance payments are encouraged and refunds are sometimes made for unused payments. 83 T.C. at 578. The Churches promote participation in their religious services, using such techniques as free lectures, handouts and media advertising, but they do not actively solicit contributions from members or from the public other than through fixed donations for participation in these religious services. (Stip. Rec. I. 21-22, ¶ 41). 83 T.C. at 579.

Although the Churches perform a variety of services for their members without charge, including weddings, christenings, and funerals, and offer a specialized form of auditing to help people in crisis for which no donation is expected, participation in the religious services of

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[5] Auditing, for example, is given in sessions. An "Intensive" is a specific number of hours—12½ or 25—intended to be given over a short period of time. (Stip. Rec. I, 18, ¶ 21).

auditing and training generally is conditioned on fixed donations. Such payments, the major source of funding for the Church, are at issue here. (Stip. Rec. I 21, ¶¶ 39, 40). *See also* Tr. 136-39, 199-200; 83 T.C. at 578.

The Tax Court found that the Church's system of fixed donations is the application of a religious doctrine, "the Doctrine of Exchange." 83 T.C. at 577. Amounts of fixed donations traditionally have been set at levels that correspond roughly to a percentage of the income of church members. For example, the Tax Court found that 25 hours of auditing historically has correlated with three months' pay for average middle-class workers in the church district. 83 T.C. at 578 n.7. Dr. Love's uncontradicted expert testimony established that such fixed or prescribed fees for participation in religious practices are comparable to "seat fees" in the Jewish faith, pew rentals and Mass fees in the Protestant and Catholic traditions, and tithing in Mormonism. (Tr. 302-04, 305-08, 311-13).

3. The Commissioner's position in this case is that payments by individuals to participate in the religious sacraments of their church may be disallowed depending on the form of such payment and the nature and value of the religious service provided. The Tax Court agreed, but the Second Circuit reversed.

The Second Circuit held that respondents' payments for religious services were deductible. The court noted that under IRS rulings, court opinions, and the legislative history of § 170, "[d]onations related to participation in religious observances have not been regarded as yielding specific private benefits to the donor, who is considered only an incidental beneficiary, the primary beneficiaries being the members of the faith and the general public." 844 F.2d at 96. The court stated that:

> [T]here is no way of measuring spiritual or religious benefits in such a way as to conclude that they are commensurate with the fees paid for participation in the religious activities giving rise to those benefits. The better rule is to avoid any attempted measurement and to hold 'that regardless of the timing of the payments or details of the church's method of soliciting contributions from its members, an amount remitted to a qualified church with no return other than participation in strictly spiritual and doctrinal religious practices is a contribution within the meaning of section 170.'

Id. quoting Staples, 821 F.2d at 1327.

4. In its petition for certiorari the government notes that the statutory "question presented in this case is identical to that presented in the consolidated cases of *Hernandez v. Commissioner* . . . and *Graham v. Commissioner* . . . ." Pet. at 4. Respondents agree and do not oppose the petition for a writ of certiorari in this case.

5. The government's petition in this case does not present at all the constitutional question at issue in this case and the related cases. However, despite the government's effort to limit review in *Hernandez* to the statutory question, this Court's grants of certiorari in both *Hernandez* and in *Graham* were not so limited. Thus, if review of the Second Circuit decision here is granted, a fair hearing requires that this Court's review should also include consideration of the important first amendment issues already accepted for review by this Court in the consolidated *Hernandez* and *Graham* cases.

CONCLUSION

The government's pending petition for a writ of certiorari to review the judgment of the Second Circuit in this case should be disposed of as appropriate in light of this Court's decision on the merits in *Hernandez v. Commissioner*, No. 87-963 and *Graham v. Commissioner*, No. 87-1616.

Respectfully submitted,

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August, 1988

APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

First Amendment

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . .

Internal Revenue Code of 1954 (26 U.S.C.) § 170—Charitable, etc., Contributions and Gifts *

(a) Allowance of deduction.

(1) General rule. There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. * * *

(b) Percentage limitations.

(1) Individuals.—In the case of an individual, the deduction in subsection (a) shall be limited as provided in the succeeding subparagraphs.

(A) General rule. Any charitable contribution to—

(i) a church or a convention or association of churches.

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* Only those portions of 26 U.S.C. § 170 and 26 U.S.C. § 501 relevant to the discussion in this petition are set forth here. References to Title 26 United States Code are to the Internal Revenue Code of 1954, which was in effect when the tax returns at issue in this case and related cases were filed and when the Commissioner's notices of deficiency were issued. As part of the Tax Reform Act of 1986, the 1954 Code was redesignated the Internal Revenue Code of 1986. Pub. L. 99-514 § 2(a), 100 Stat. 2085, 2095. The portions of sections 170 and 501 of the 1954 Code pertinent to this case were not changed by the Tax Reform Act of 1986 and remain in force in identical form.

shall be allowed to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year.

(c) Charitable contribution defined. For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of:

* * * *

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

* * * *

Internal Revenue Code of 1954 (26 U.S.C.)
§ 501—Exemption From Tax on Corporations, Certain Trusts, Etc.

(a) Exemption From Taxation. An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * * *

(c) List of Exempt Organizations. The following organizations are referred to in subsection (a):

* * * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * * *